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Indirect Tax Conference 2015

Real Estate

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Annual update

Overview

What's been happening?

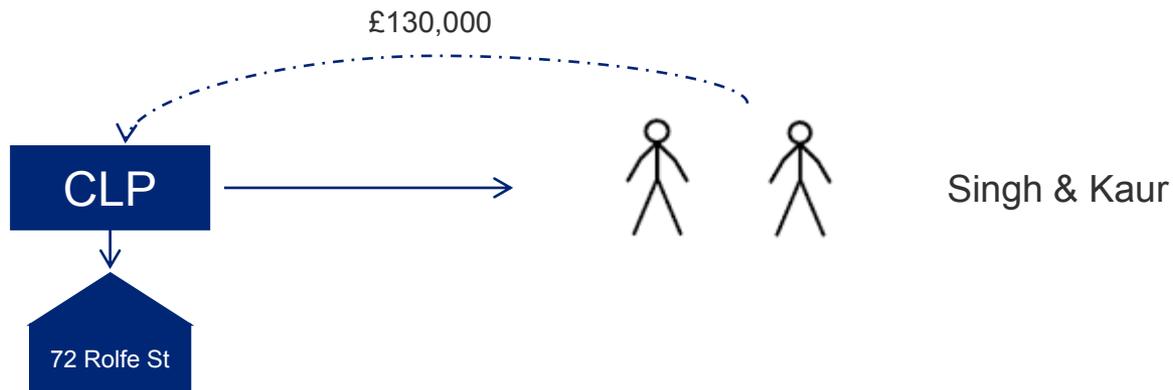
- HMRC
- Cases
- Questions?

HMRC

- New policy holder
- Options to tax
- VAT clearances
- Technical discussion groups
- Revenue & Customs Briefs

CLP Holding Company Ltd v Singh [2014]

Could VAT be added to the price?



- 4th edition of Standard Conditions:
 - “Sums payable are exclusive of VAT”
- Contract:
 - Price defined as “£130,000”

Roy Shields [2014]

Occupancy restriction, whether a dwelling?

- The law:
 - “...the separate use, or disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision...”
- Planning permission:
 - “The occupation of the dwelling shall be limited to a person solely employed by the equestrian business at 274 Bangor Road, Newtownards, and any resident dependents.”

Astral Construction Ltd [2015]

Was a new building constructed?

- Care home “constructed”
- Linked to disused church

Institute for Orthodox Christian Studies [2015]

Whether property used for a relevant charitable purpose?

- Charity acquired premises
- Seller had opted to tax
- Charity would occupy premises and temporarily sublet some rooms

Taylor Wimpey plc

“White goods” blocking order

- HMRC won at First-tier Tribunal ...
- ... appeal listed at Upper Tribunal ...

TOGC's – case law developments

TOGC's

Basics

- A TOGC is the sale of a business (or part of a business) which is treated as neither a supply of goods nor a supply of services and is therefore outside the scope of VAT.
- Additional conditions are required to be met where land and property is being disposed of. (e.g. mirrored option to tax, notification from buyer that option to tax will not be dis-applied etc.).
- TOGC treatment is beneficial for a vendors cash flow and for VAT sensitive buyers.
- TOGC treatment also reduces the amount of SDLT payable by the buyer (as SDLT is payable on the VAT inclusive consideration)

Zita Modes [2005]

Same kind of business?

- Luxembourg retailer sold the assets of a retail clothing business VAT-free as a TOGC.
- LTA : purchaser “*had no administrative authorisation to trade in the relevant sector*”.
- ECJ : (1) the assets transferred must form “*a sufficient whole to allow the pursuit of an economic activity and that activity must be pursued by the transferee*”; and
(2) Buyer’s intention post transfer must relate to an activity that will have a degree of continuity or similarity to that of the seller pre-transfer.
- But no requirement under Art. 5(8) for the buyer **to operate the same kind of business** as that carried on by the seller prior to the transfer.

Dartford Borough Council [2006]

Agreements for Lease

- Development Agreement followed by tri-partite Agreement for Lease, followed by a freehold land disposal.
- HMRC assessed for output tax as did not agree TOGC. Taxpayer appealed.
- Tribunal accepted the appeal and found that “*at the time of sale the appellant was carrying on an economic activity in relation to the site*” which the buyer would carry on.
- Tribunal strongly criticised HMRC for failing to understand “*the nature of an agreement for lease*”

Robinson Family Limited [2012]

Sale of inferior interest?

- Robinson purchased a site and re-developed it constructing six new commercial units. One unit sold via a long lease (as a TOGC) to an insurance broker.
- HMRC view pre-litigation was no TOGC (just the creation of a new asset) where an inferior interest granted.
- HMRC now accept that where a vendor retains a small reversionary interest in a property being transferred does not prevent transaction from being a TOGC.
- Sale of inferior interest in a property letting business can therefore be a TOGC providing the interest retained is small enough not to disturb the substance of the transaction.
- Subsequent change in HMRC policy (see HMRC Brief 30/12).

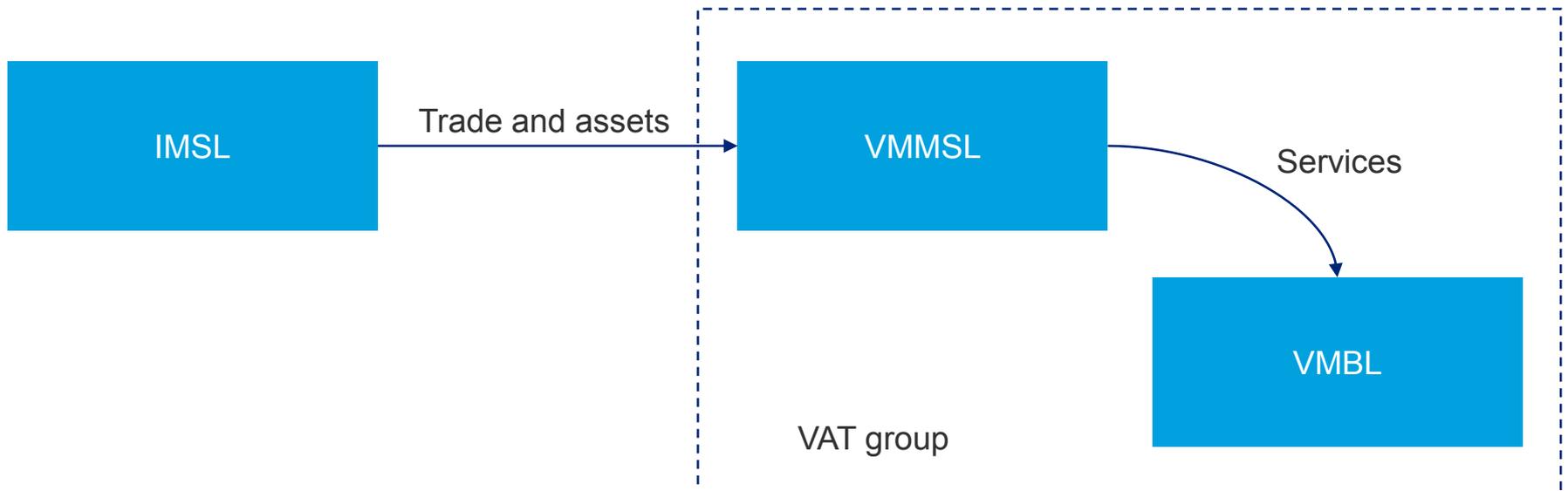
Royal College of Paediatrics [2015]

TOGC where buyer introduces tenant?

- College partially exempt.
- College wanted new premises – opted to tax.
- College introduced tenant to seller.
- Letting conditional on exchanging sale contract.

Intelligent Managed Services Ltd [2015]

TOGC where customer in buyer's VAT group?



- IT banking services.
- VAT group provided retail banking services.

Intelligent Managed Services Ltd [2015]

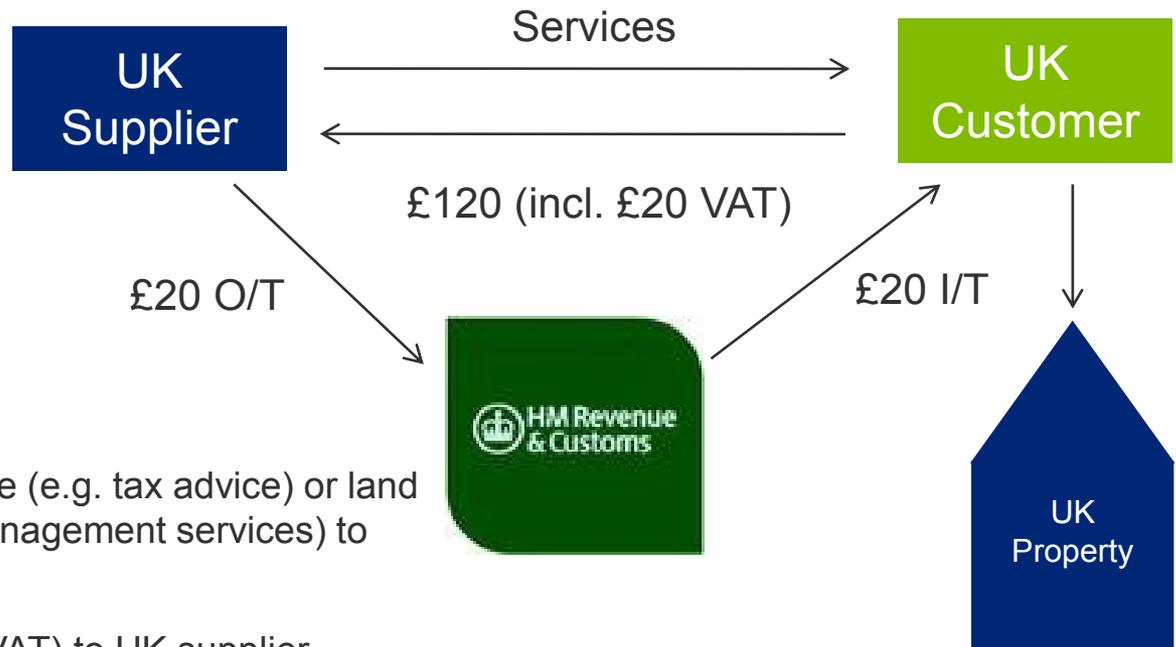
What next?

- Sales of properties where only tenant VAT-grouped with seller or buyer?
- Sale and leasebacks?
- Tenants purchasing their rented premises?

Cross-border issues

Principles of VAT

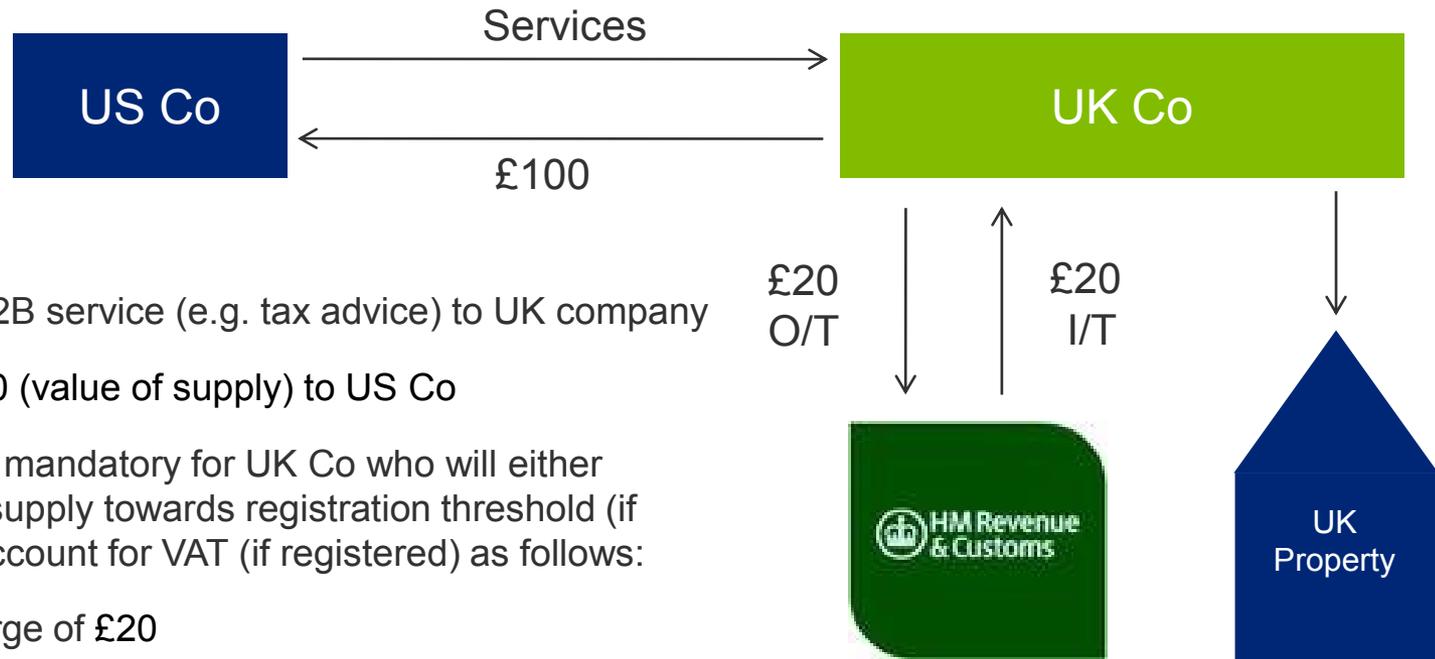
VAT on domestic supplies



- UK supplier provides B2B service (e.g. tax advice) or land related service (e.g. property management services) to UK customer
- UK customer remits £120 (incl. VAT) to UK supplier
- UK supplier accounts for £20 output tax to HMRC
- UK customer recovers £20 input tax from HMRC (assume a fully taxable business)
- Basic EU principle

Principles of VAT

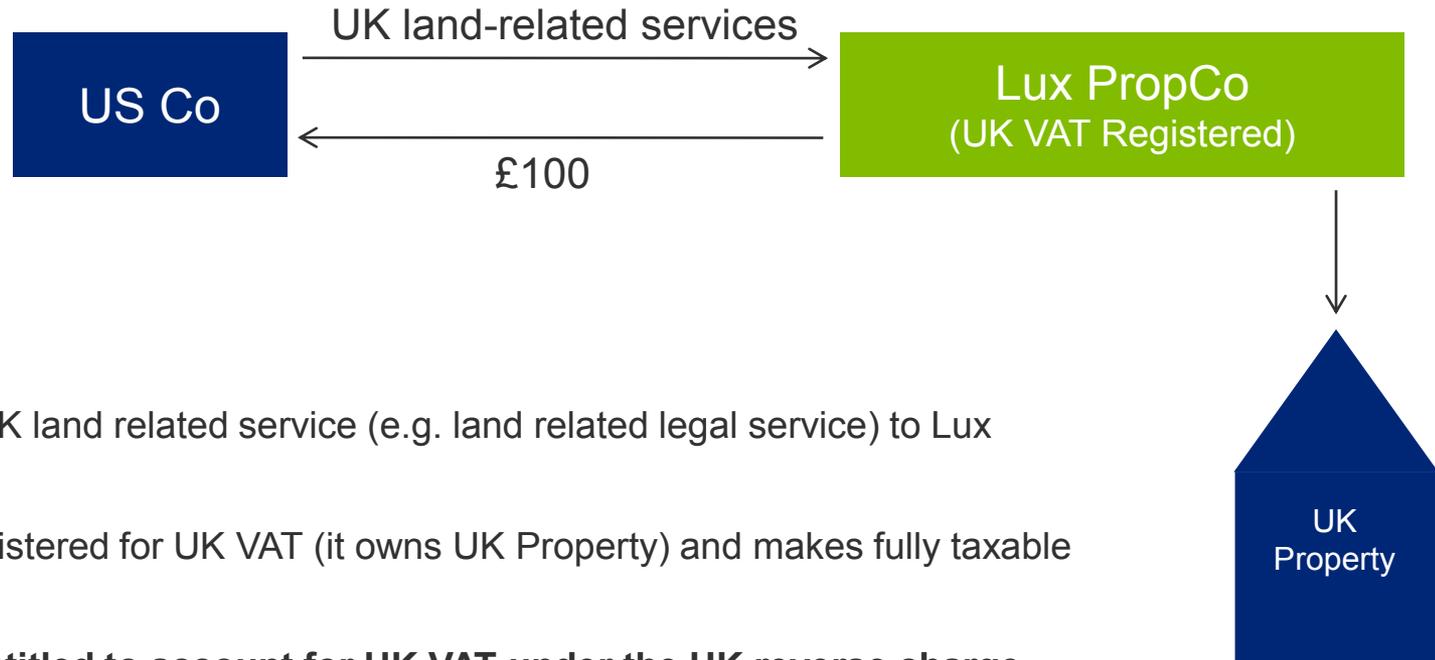
Reverse charge



- US Co provides B2B service (e.g. tax advice) to UK company
- UK Co remits £100 (value of supply) to US Co
- Reverse charge is mandatory for UK Co who will either consider value of supply towards registration threshold (if unregistered) or account for VAT (if registered) as follows:
 - Output tax charge of £20
 - Input tax charge of £20
- Reverse charge is **mandatory** for UK Co if registered for UK VAT and receiving **UK land related** services.

Principles of VAT

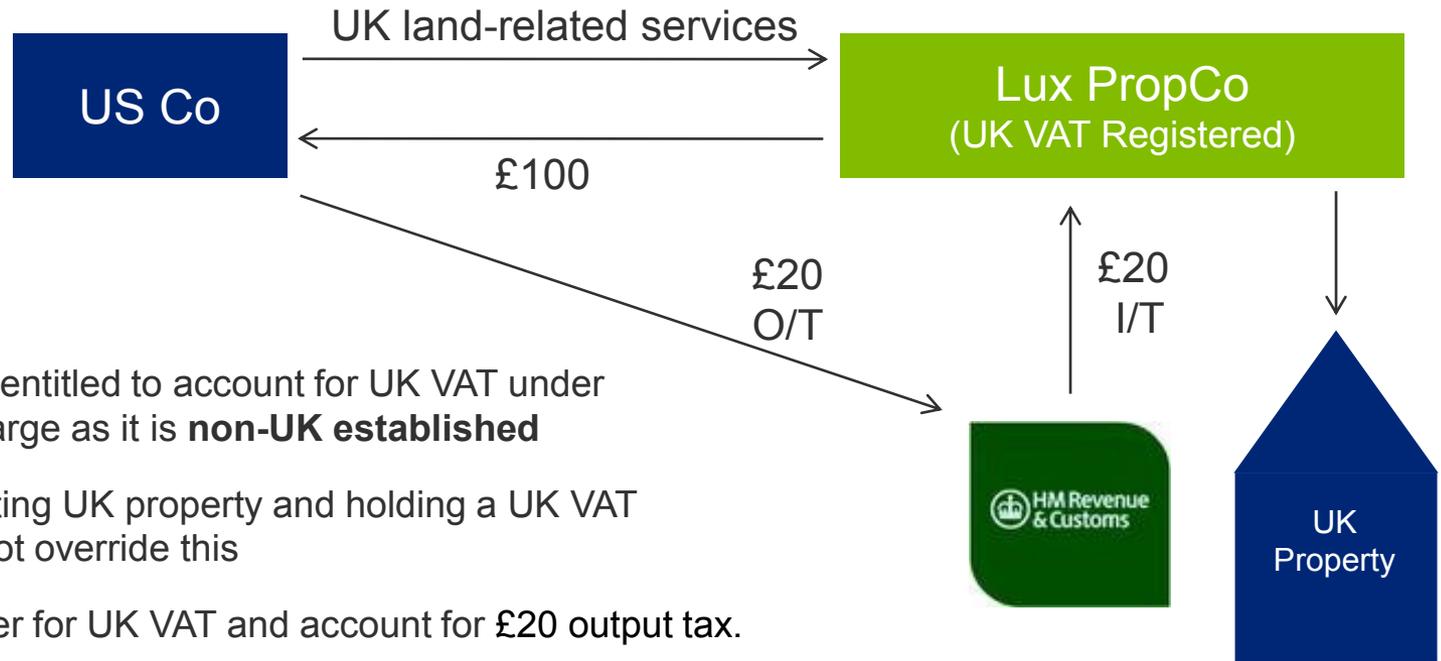
Reverse charge issues: Establishment



- US Co provides UK land related service (e.g. land related legal service) to Lux PropCo
- Lux PropCo is registered for UK VAT (it owns UK Property) and makes fully taxable lettings
- **Is Lux PropCo entitled to account for UK VAT under the UK reverse charge provisions or is US Co required to register for UK VAT?**

Principles of VAT

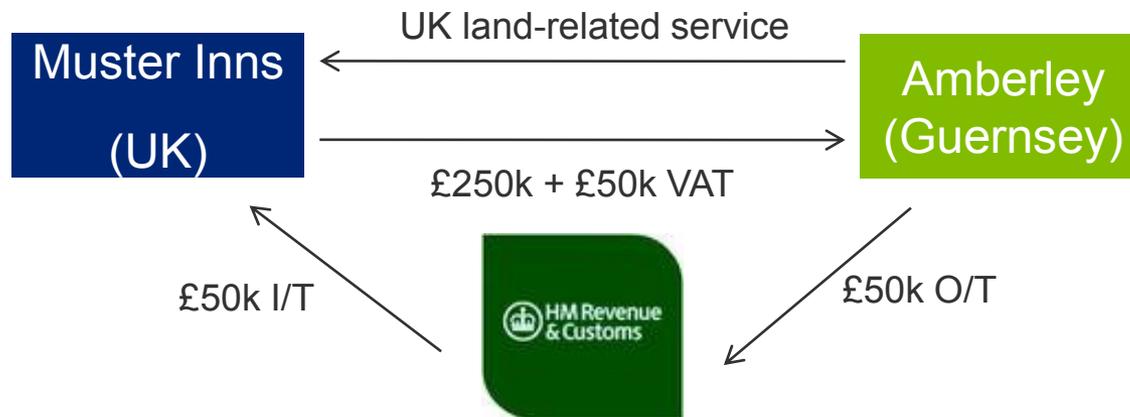
Reverse charge issues: Establishment



- Lux PropCo is **not** entitled to account for UK VAT under the UK reverse charge as it is **non-UK established**
- Lux PropCo exploiting UK property and holding a UK VAT registration does not override this
- US Co must register for UK VAT and account for £20 output tax.
- Creates a registration obligation for non-established traders (e.g. land-related professional fees)
- Risk of disallowance of input tax recovery if Lux PropCo incorrectly applies reverse charge (primarily a cash flow issue)

Cross-border issues

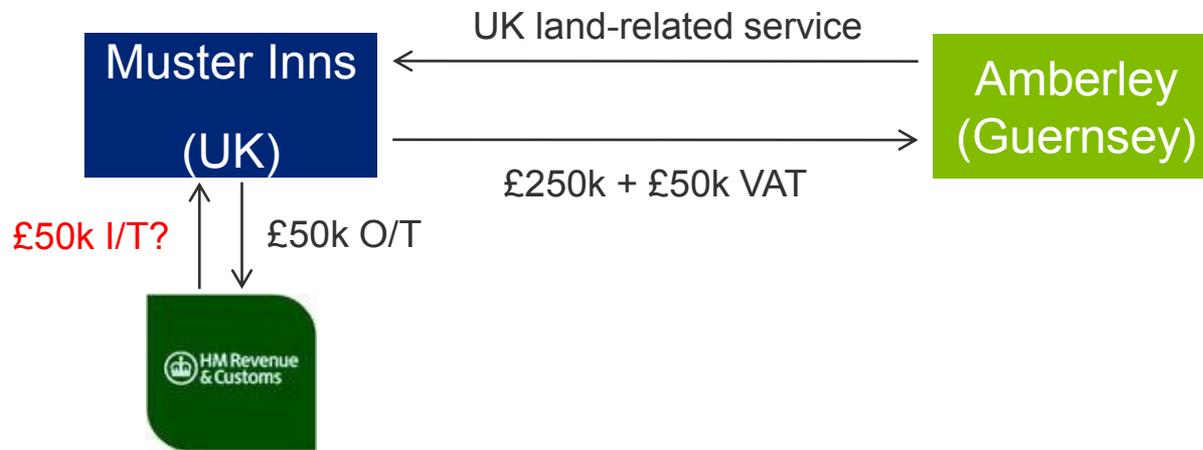
Case law – Muster Inns Ltd



- Muster Inns engaged with Amberley Construction Ltd for construction works to refurbish its public house/restaurant
- Amberley as a non-UK established business registered for UK VAT and accounted for output tax to HMRC on its supply of construction services to Muster Inns
- Muster Inns recovered the VAT incurred on the services which, following review by HMRC, was paid.

Cross-border issues

Case law – Muster Inns Ltd



- HMRC decided to cancel Amberley's UK VAT registration with retrospective effect
- No fixed establishment as the UK human and technical resources were of a temporary nature
- Muster Inns should have instead accounted for VAT under the UK reverse charge provisions (see diagram above)
- HMRC issued Muster Inns an assessment for output tax due under the reverse charge.
- Muster Inns suffered fixed cost with recourse only to Amberley
- Did Amberley get a refund?

Land-related services

Services connected to immovable property

Implementing Regulation No 1042/2013	Subject
Art. 13b	What is immovable property?
Art. 31a1	What is a service connected to immovable property?
Art. 31a2	Services that are connected to immovable property
Art. 31a3	Service not connected to immovable property

Land-related services

Services connected to immovable property

What is immovable property?

Land – a specific part of earth above or below over which title and possession can be created

A building or construction affixed to land (above or below sea level) that cannot easily be dismantled or moved

Any item that makes up an integral part of the building

Machines permanently installed in a building that can not be moved without destroying or altering the building or construction

Land-related Services

Services connected to immovable property

What is a service connected to immovable property?

- A service is connected to immovable property where there is **sufficient direct connection** with that property
- **Sufficient direct connection** exists where a service is:
 - derived from an immovable property and that property makes up a constituent element of the service and is central to, and for, the service provided; or
 - provided to, or directed towards, an immovable property, having as their object the legal or physical alteration of that property.

Land-related services

Services connected to immovable property

Art. 31a2: Services connected to immovable property	Art. 31a3: Services <u>not</u> connected to immovable property
Leasing or letting of immovable property	Provision of stand location at fair/exhibition with other related services to enable exhibitor to display items
Legal services relating to transfer of title to immovable property, establishment or transfer of interests in property	Legal services connect to contracts where not specific to transfer of title etc (e.g. contract enforcement, prove existence of a contract)
Property management	Portfolio management of investments in real estate
Intermediation in the sale, leasing or letting of immovable property	Intermediation in the provision of hotel accommodation or similar
Construction and maintenance of buildings and other permanent structures	Installation, maintenance etc of machines and equipment which is not, or does not become, part of the property
Valuation and surveying services	Advertising

Land-related services

Services connected to immovable property

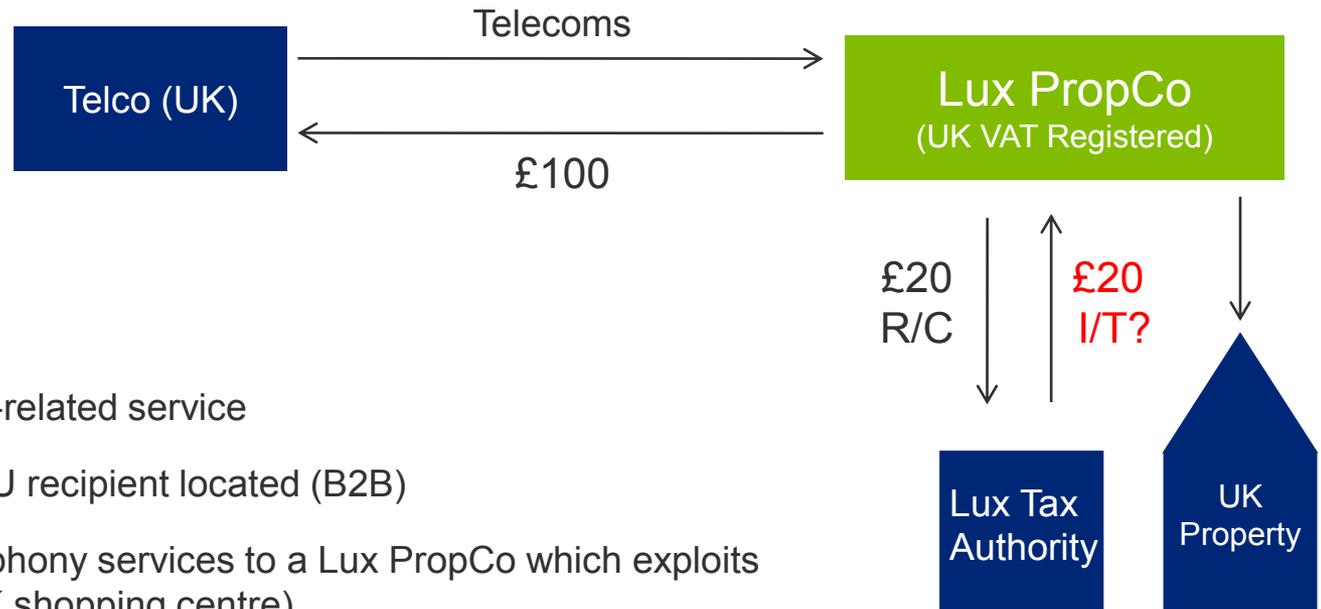
Inconsistent treatment across the EU?

For example:

Services connected to immovable property?			
Service	EU Country	Land-related service?	Land-related service in UK?
Due diligence for the sale of immovable property	Finland	Yes (Recent case law)	No
Tenant pays the landlord to prematurely terminate a lease	France	No (Compensation?)	Yes
Rent-free periods	Germany	Yes (Rent reduction?)	No

Land-related services: Examples

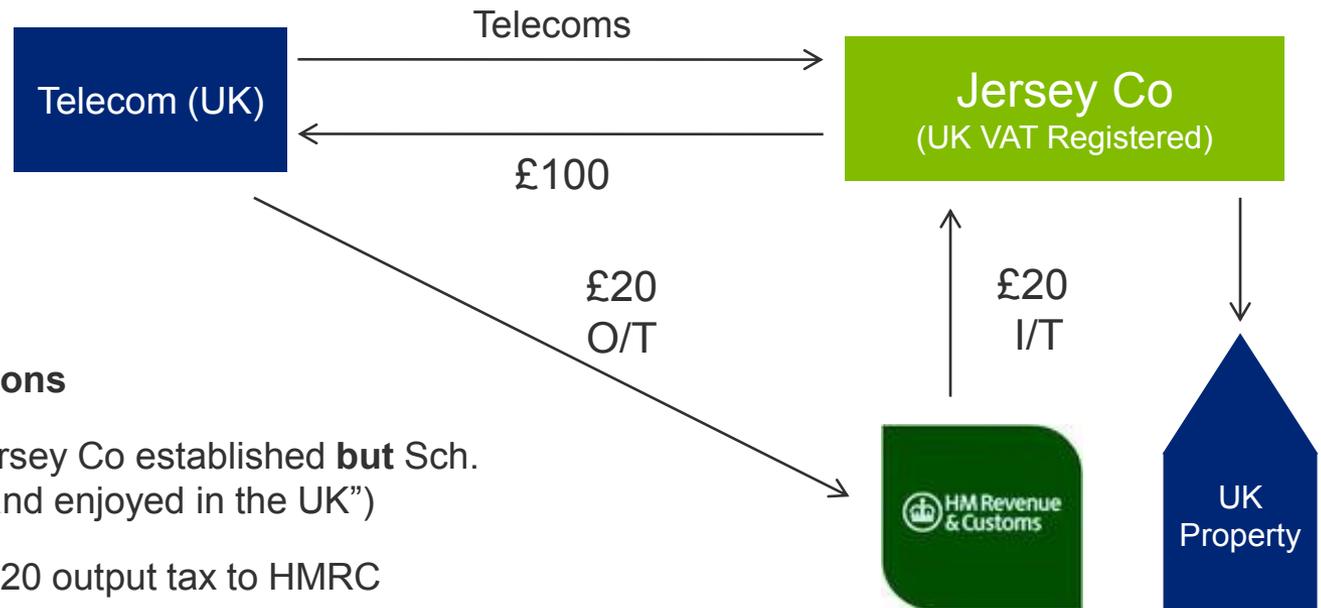
Telecommunication services



- Telecoms are **not** a land-related service
- Place of supply where EU recipient located (B2B)
- Telco (UK) provides telephony services to a Lux PropCo which exploits taxable property (e.g. UK shopping centre)
- Lux PropCo remits £100 (value of supply) to Telco (UK) and must account for Lux VAT under Lux reverse charge provisions
- Lux PropCo recovers to the extent UK property **may** qualify against Lux OTT criteria
- **How can this position change?**

Land-related services: Examples

Telecommunication services



Use and Enjoyment provisions

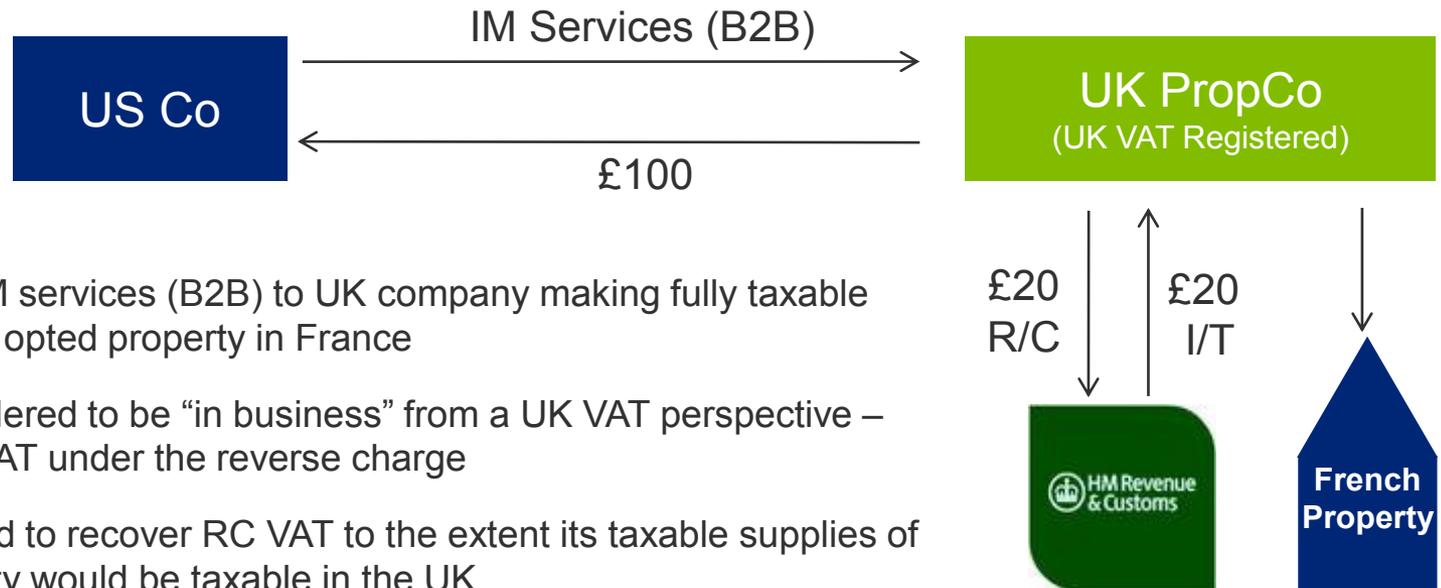
- Place of supply where Jersey Co established **but** Sch. 4a overrides this (“used and enjoyed in the UK”)
- Telco (UK) accounts for £20 output tax to HMRC
- Jersey Co recovers £20 input tax correctly charged to it subject to normal UK VAT recovery rules

Considerations

- Common for EU PropCo’s to be incorrectly charged UK VAT
 - Supplier incorrectly accounts for output tax
 - Recipient recovers VAT it is not entitled to and has potential reverse charge liability in country of establishment
- Onus is on recipient seeking to recover VAT to ensure supplier is correctly charging VAT

Land-related services: Examples

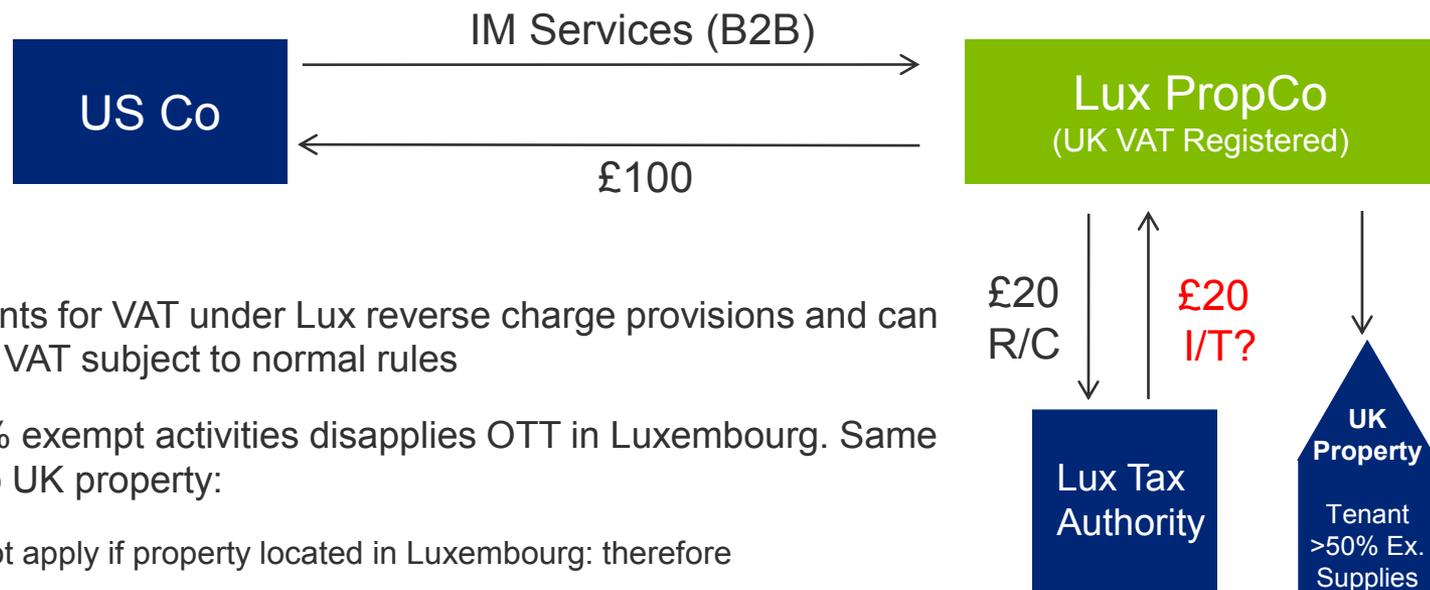
Investment Management Fees



- US Co provides IM services (B2B) to UK company making fully taxable lettings of a single opted property in France
- UK PropCo considered to be “in business” from a UK VAT perspective – accounts for UK VAT under the reverse charge
- UK PropCo entitled to recover RC VAT to the extent its taxable supplies of the French property would be taxable in the UK
- **Same treatment across the EU?**

Land-related services: Examples

Investment Management Fees

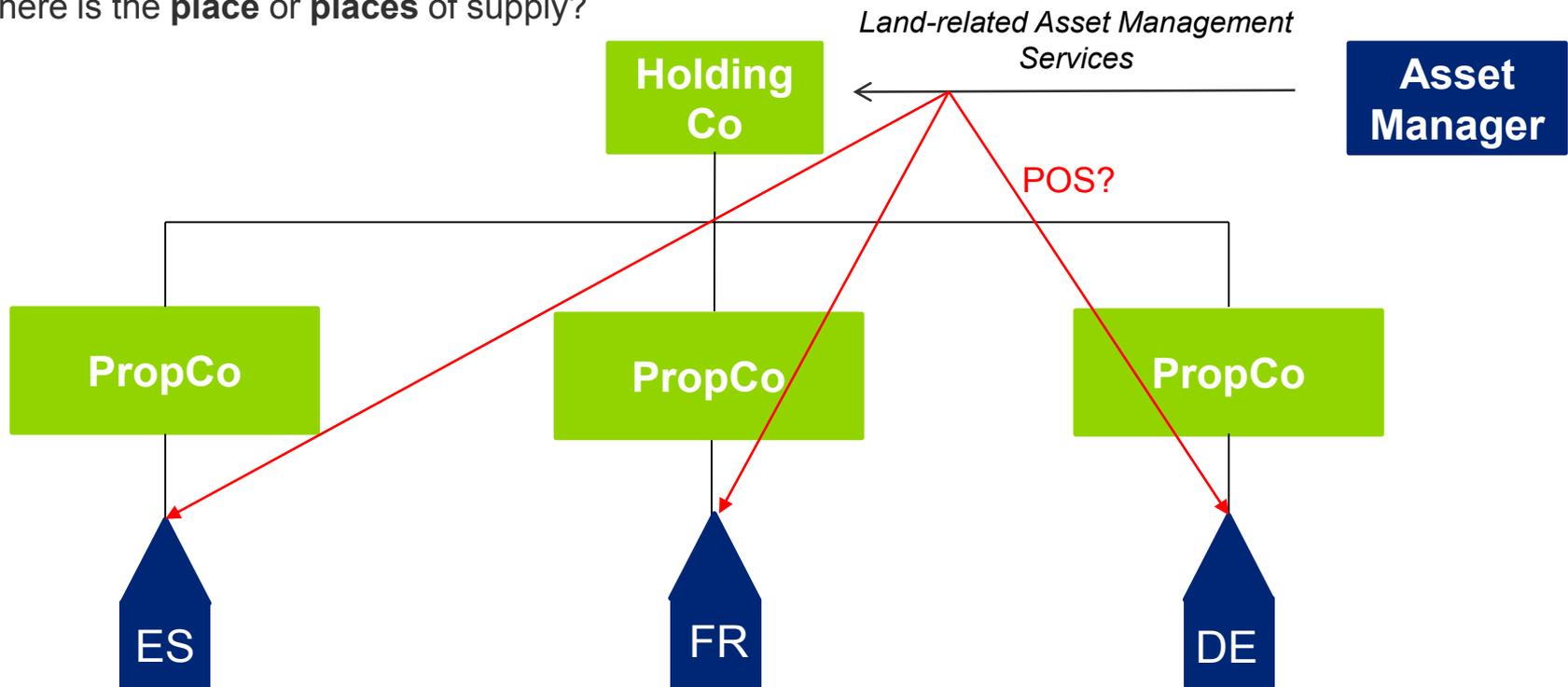


- Lux PropCo accounts for VAT under Lux reverse charge provisions and can potentially recover VAT subject to normal rules
- A tenant with >50% exempt activities disapplies OTT in Luxembourg. Same principle applied to UK property:
 - Lux OTT would not apply if property located in Luxembourg: therefore
 - Recovery of RC VAT in Luxembourg disallowed (regardless of UK OTT having effect)
- Differing applications in the EU for example:
 - Germany
 - Netherlands
 - France

Land-related services: Examples

Asset Management Services – Global contracts

- Asset manager provides asset management services with certain land-related element relating to portfolio of properties located in various EU jurisdictions
- Single supply of B2B services or separate supplies comprising a mix of B2B and land-related services?
- Where is the **place** or **places** of supply?



Land-related services: Examples

Asset Management Services – Global contracts

- European Commission (explanatory notes 1041/2013):

“Services linked to several immovable properties can not be considered as lacking a sufficiently direct connection with immovable property simply because these immovable properties are located in different Member States”

However

“Where more than one immovable property is involved in the supply, each of them has to be clearly identified”

- No guidance exists on the method of how to treat or split such services for VAT purposes.
- Possible solution?
 - Attribute land-related element?
 - Supply services directly?

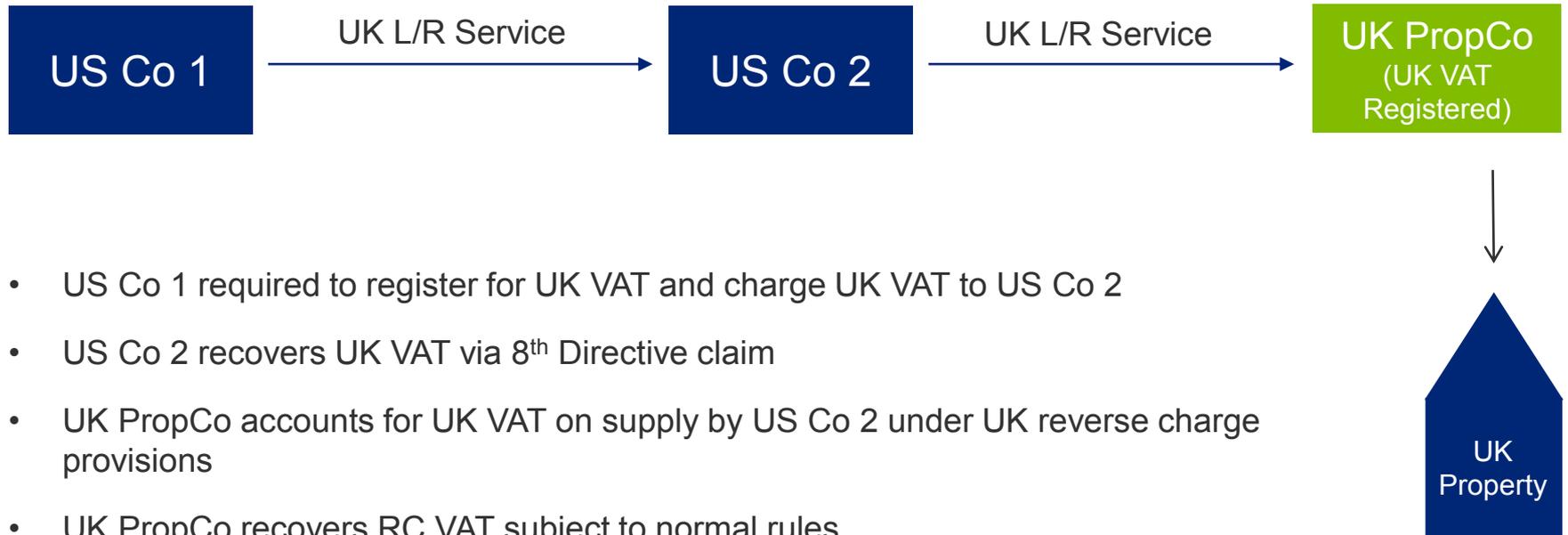
Land-related services

Key points

- Businesses seeking to recover UK VAT must ensure the VAT has been correctly charged by the supplier regardless of place of belonging (e.g. B2B supplies to Lux PropCo).
- Recipients of services must mandatorily account for VAT under the reverse charge where conditions are satisfied (e.g. recipient incorporated, and registered for VAT, in the UK for land related services).
- Risk of assessment from HMRC if VAT is incorrectly recovered or incorrectly accounted for by Recipient with recourse limited to supplier. VAT can become fixed cost when ordinarily it shouldn't be.
- Where VAT has been incorrectly charged, revert back to supplier for replacement invoice with correct VAT treatment.
- Consider which recipient(s) receive and pay for services to ensure VAT does not become a sticking cost in light of EU nuances e.g:
 - Lux Co incurring RC VAT with >50% exempt tenant in the UK
 - Hold Co's incurring VAT on related services etc.

Lessons learnt from elsewhere

Land-related supplies and the reverse charge: Recap

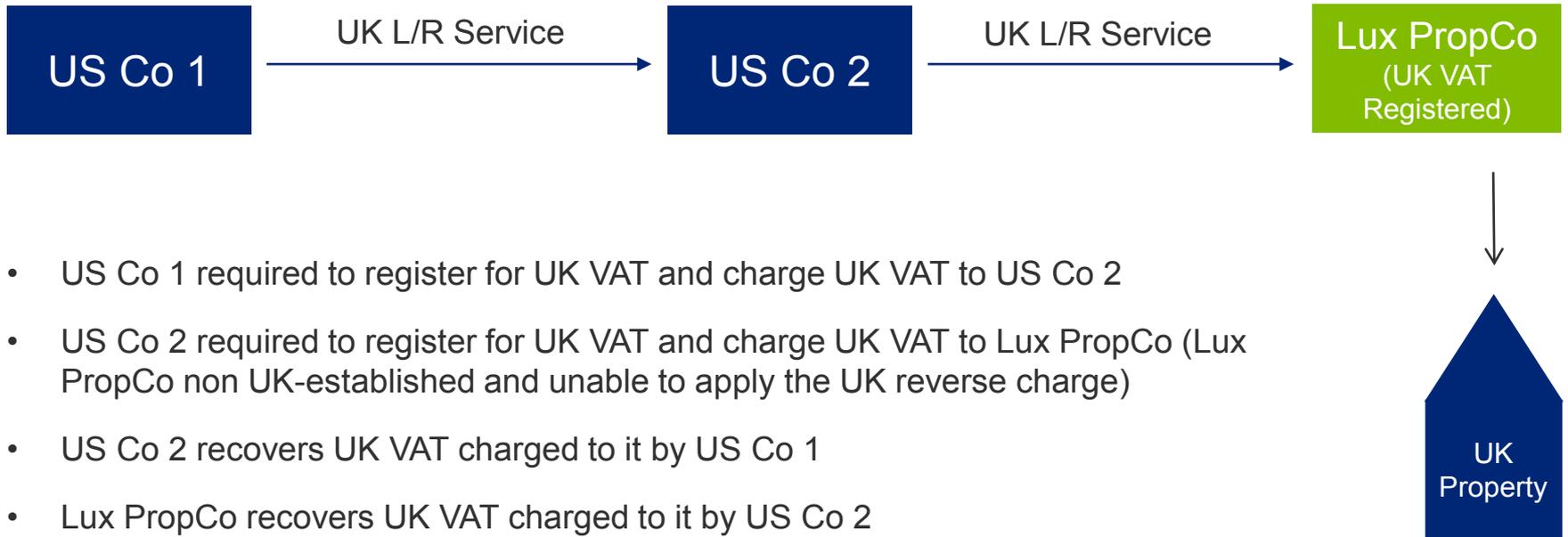


Note

- A **Lux PropCo** (i.e. Lux established) with a Lux VAT registration and Lux property would be unable to apply Lux reverse charge
- US Co 1 and US Co 2 would be required to register for Lux VAT (similar to above)

Lessons learnt from elsewhere

Land-related supplies and the reverse charge: Non-established PropCo's



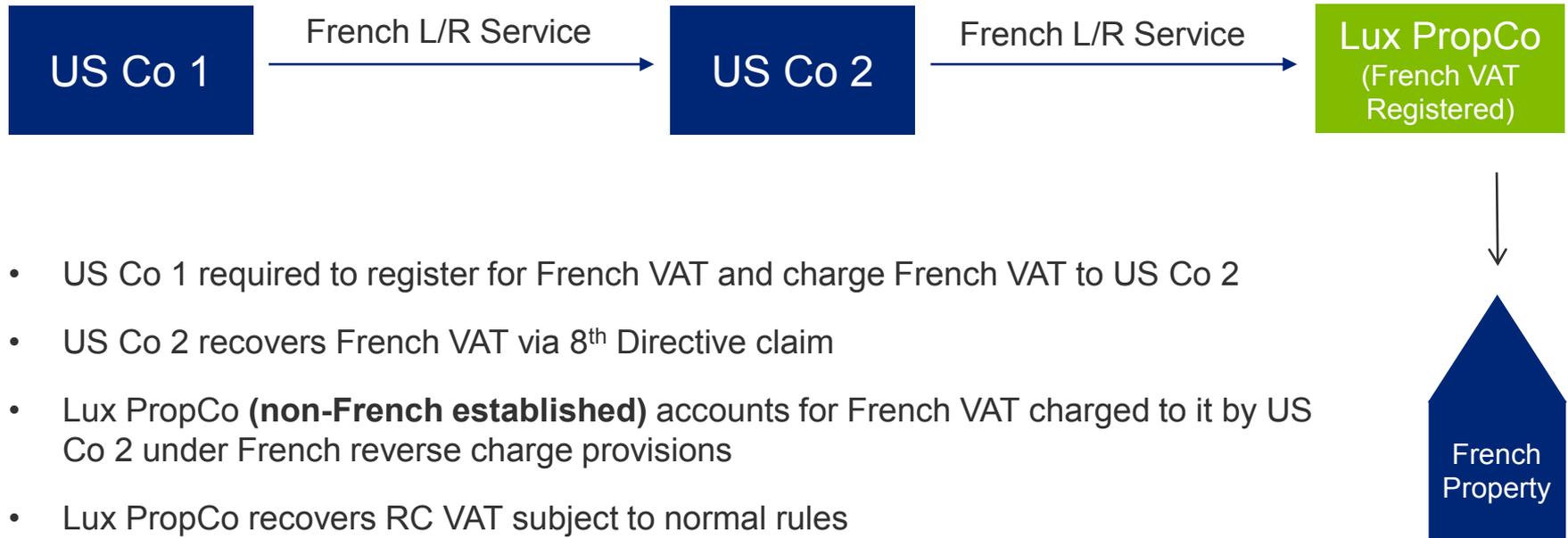
- US Co 1 required to register for UK VAT and charge UK VAT to US Co 2
- US Co 2 required to register for UK VAT and charge UK VAT to Lux PropCo (Lux PropCo non UK-established and unable to apply the UK reverse charge)
- US Co 2 recovers UK VAT charged to it by US Co 1
- Lux PropCo recovers UK VAT charged to it by US Co 2

Note

- A **UK PropCo** with a Lux VAT registration and Lux property would be unable to apply Lux reverse charge
- US Co 1 and US Co 2 would be required to register for Lux VAT (similar to above)

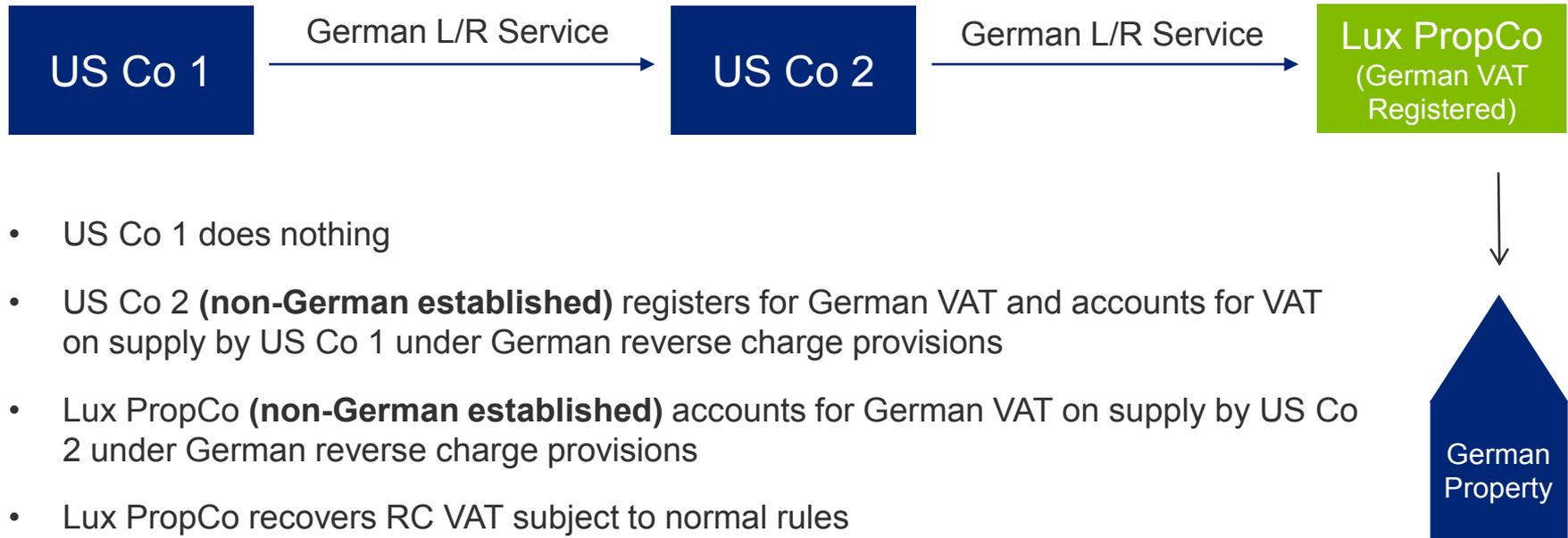
Lessons learnt from elsewhere

Land-related supplies and the reverse charge: Non-established PropCo's



Lessons learnt from elsewhere

Land-related supplies and the reverse charge: Non-established PropCo's



- US Co 1 does nothing
- US Co 2 (**non-German established**) registers for German VAT and accounts for VAT on supply by US Co 1 under German reverse charge provisions
- Lux PropCo (**non-German established**) accounts for German VAT on supply by US Co 2 under German reverse charge provisions
- Lux PropCo recovers RC VAT subject to normal rules

Lessons learnt from elsewhere

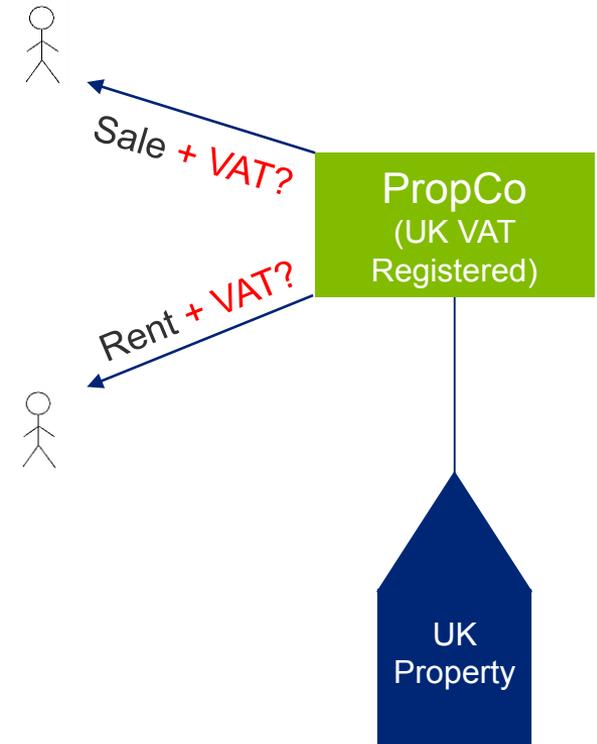
Option To Tax: UK

Basic principles: UK position

- Generally the sale and letting of immovable property is exempt of VAT
- Limited exceptions to exempt treatment in the UK e.g.
 - First grant of major interest in a dwelling
 - Sale of freehold in new (less than 3 year old) commercial property

Implications

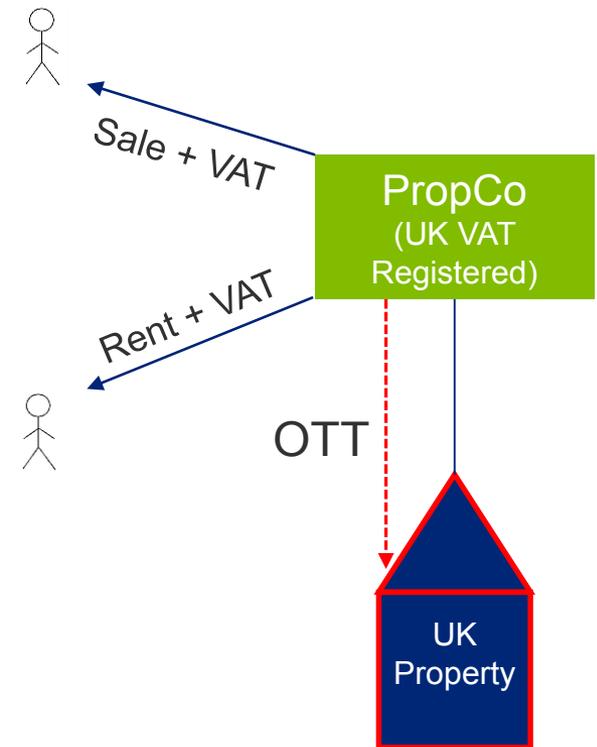
- General restriction on input tax recovery e.g. VAT incurred on:
 - Construction and maintenance costs
 - Land-related transaction costs
 - Reverse charge VAT on B2B services
- Close interaction with Capital Goods Scheme adjustments
- **Can the position be changed?**



Lessons learnt from elsewhere

Option To Tax: UK

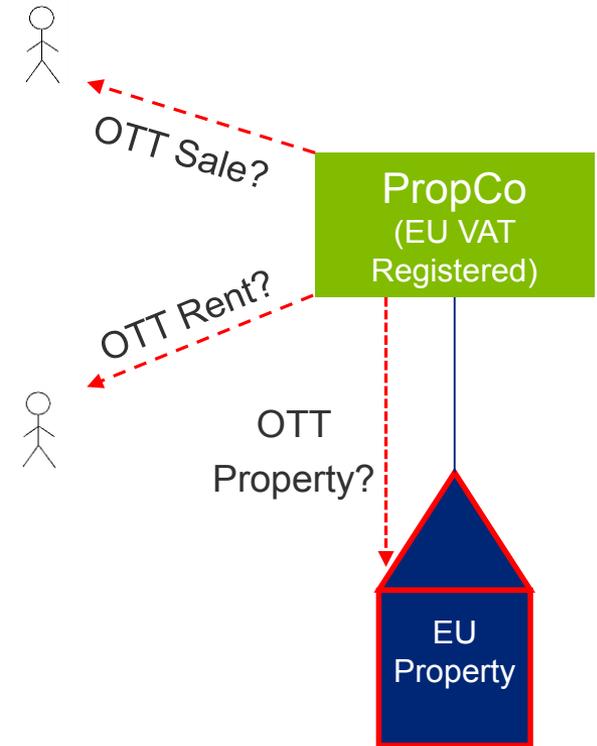
- Owner can exercise an option to tax on **whole** building
- Must notify tax authorities within 30 days of deciding to opt
- OTT never applies to residential properties
- Once opted, subsequent supplies of property by **opter** are subject to UK VAT e.g. lease payments, freehold sales
- Entitled to recover input tax to extent taxable supplies are made (e.g. construction costs)
- Strict rules concerning mandatory disapplication of option to tax in relation to individual grants



Lessons learnt from elsewhere

Option To Tax: EU

- Principle of opting to tax or “electing to waive exemption” is common around the EU
- OTT applied and disapplied in varying ways (Country specific)
- Lack of consistency (e.g. giving effect, timing, disapp rules etc)
- Frequent CGS implications

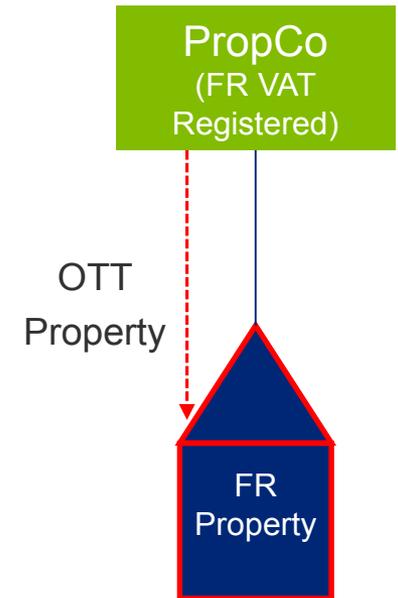


Lessons learnt from elsewhere

Option To Tax: EU

France

- OTT applies to the whole building
- Must notify OTT to French tax authorities
- No disapplication rules: OTT applies regardless of exempt/non-business tenant
- Close interaction with TOGC rules (i.e. notification timings)
- No retrospective effect

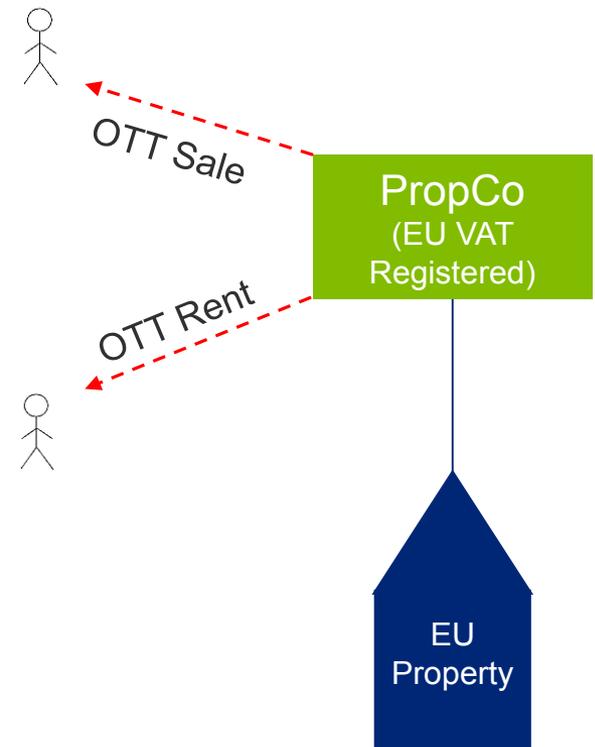


Lessons learnt from elsewhere

Option To Tax: EU

Common EU practice

- Option to tax can apply to each individual grant of a property for example:
 - i) OTT can be given effect via clause/warranty in sale agreement or lease e.g. in Germany & Netherlands; or
 - ii) OTT can be given effect simply by raising a VAT invoice e.g. Sweden (2014 onwards); or
 - iii) Some countries e.g. Sweden & Finland limit OTT application to letting of property only – sale of property will always be exempt or TOGC
 - iv) And then there's Belgium.....

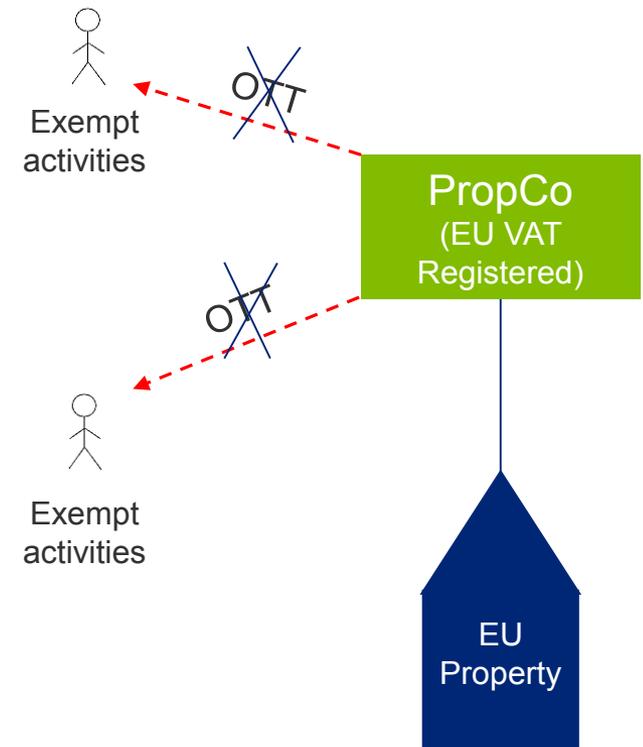
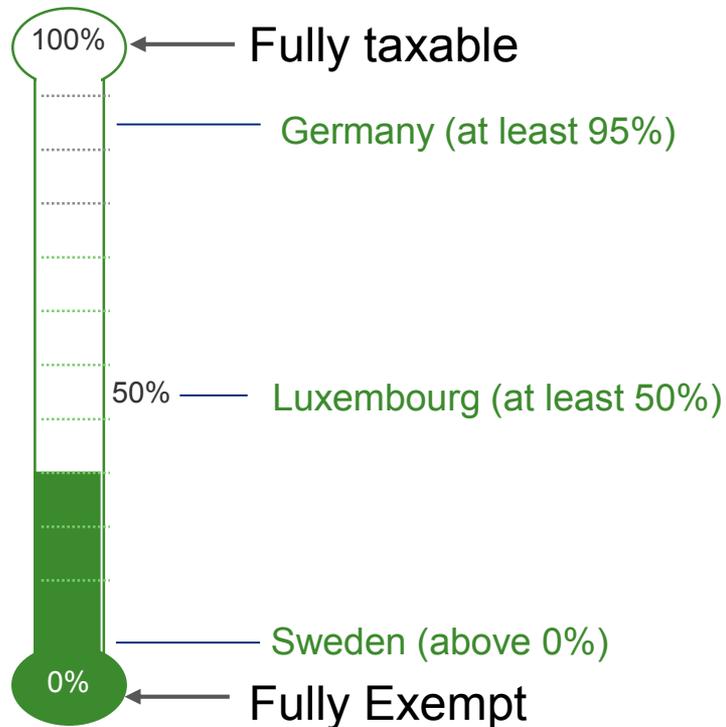


Lessons learnt from elsewhere

Option To Tax: EU

Common EU practice

- Disapplication rules vary from country to country
 - i) Automatic disapplication of OTT on grant to tenant if making a certain level of exempt supplies:

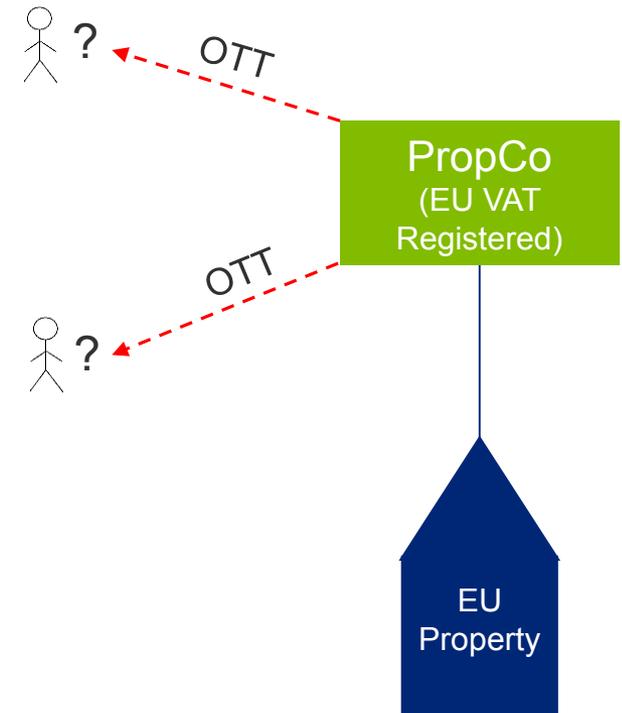


Lessons learnt from elsewhere

Option To Tax: EU

Taxable intention

- How do you demonstrate taxable intention to support VAT recovery (e.g. refurb of vacant property) without a lease (ergo no OTT)?
 - Lease agreements?
 - Public advertisements for taxable tenants?
- Closer scrutiny by tax authorities depending on location of building e.g. financial district with increased expectation of exempt tenants?
- Can result in delays to repayment of VAT



Lessons learnt from elsewhere

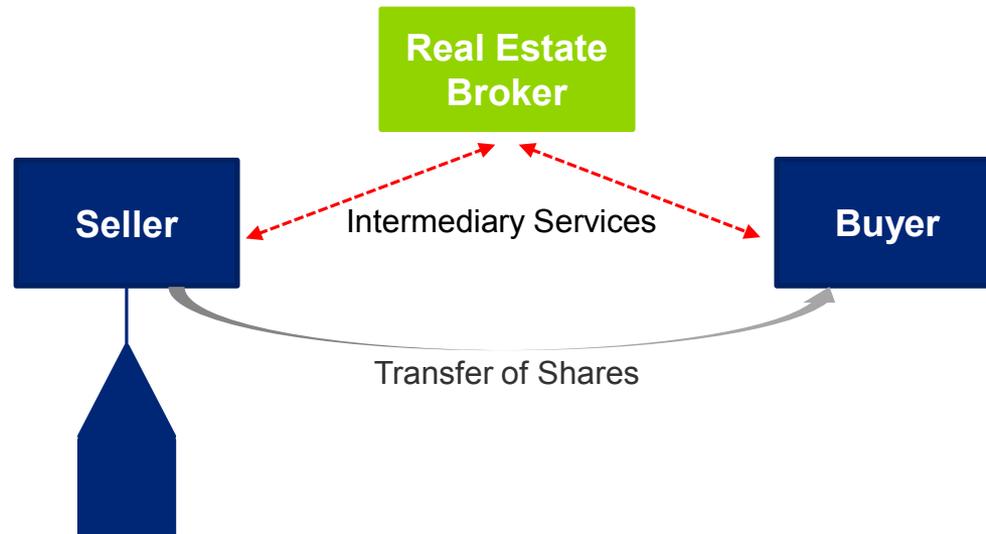
Option To Tax: EU

Key points

- Greater risk in some countries of inadvertently disturbing taxable status by letting to exempt tenants
- Impacts VAT recovery
- Greater risk for property investors who may be faced with CGS adjustments linked to VAT originally recovered by previous owner
- Longer process to prove taxable intention for VAT recovery without an option to tax (e.g. vacant property refurb)

Lessons learnt from elsewhere

Case Law: DTZ Zadelhoff Case C-259/11



- Real Estate Broker provides services to bring together Seller and Buyer **of shares in a property holding company**
- Is a supply of intermediary services taxable or exempt?

Lessons learnt from elsewhere

Case Law: DTZ Zadelhoff Case C-259/11

- **Depends**
- European Court of Justice:
- Intermediary services relating to the sale of shares of a real estate holding company are VAT exempt **unless** an EU Member State treats the shares or interest in those shares equally as a tangible property.
- Number of EU Member States adopt DTZ principles (e.g. Netherlands, UK)
- Some EU Member States (e.g. France) adopt a 'look through' pursuant to Article 15, DIR 2006/112



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